Franchise Tax Board

SUMMARY ANALYSIS OF AMENDED BILL

Author:	Correa	Analyst:	Norm Catelli	Bill Number:	AB 2365
Related Bills:	See Prior Analysis	Telephone:	845-5117	Amended Date:	04/20/2004
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Employer Hiring Qualified Employee Credit/Manufacturing Trade or Business

_____ DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended __________________________.

__X__ AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

_____ AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as introduced/amended __________________________.

_____ FURTHER AMENDMENTS NECESSARY.

_____ DEPARTMENT POSITION CHANGED TO __________________________.

__X__ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED February 19, 2004, STILL APPLIES.

_____ OTHER - See comments below.

SUMMARY

This bill would create a manufacturing jobs credit.

SUMMARY OF AMENDMENTS

The April 20, 2004, amendments refined the manufacturing jobs credit, resolving most of the implementation, technical, and policy considerations discussed in the department's analysis of the bill as introduced February 19, 2004.

New "This Bill," "Implementation Considerations," "Technical Considerations," "Fiscal Impact," "Economic Impact," and "Policy Considerations" discussions are provided below. Except for the items below, the remainder of the department's prior analysis still applies. Amendments are provided to resolve the technical issues discussed in this analysis. The Franchise Tax Board's position remains pending.

Board Position:			Legislative Director	Date
_____ S	_____ NA	_____ NP		
_____ SA	_____ O	_____ NAR	Brian Putler	5/13/04
_____ N	_____ OUA	__X__ PENDING		

THIS BILL

This bill would create a credit for manufacturers that increase the number of manufacturing jobs in California. The credit would be equal to $1,000 per qualified employee if the employee were paid at least twice the California minimum wage ($13.50 per hour) and $1,500 per qualified employee if the employee were paid at least three times the California minimum wage ($20.25 per hour).

To be eligible for the credit, a taxpayer must meet all of the following requirements:

- Be engaged in a manufacturing line of business properly classified in Codes 311 to 339999 of the North American Industry Classification System (NAICS), 2002 edition.
- Create a net increase in its manufacturing jobs in California during the taxable year compared to the 2003 taxable year. (The net increase in the taxpayer's manufacturing jobs in California is determined by the number of hours worked by hourly manufacturing employees divided by 2,000 and the total number of months worked by salaried manufacturing employees divided by 12.)
- Pay at least twice the California minimum wage (currently $6.75) to each qualified employee.
- Pay at least 80% of the qualified employee's health care insurance premiums. This requirement is met if taxpayer offers to pay 80% of the premiums, but the employee declines the coverage.

A qualified employee would mean an individual who meets all of the following:

- Is hired by the taxpayer on or after January 1, 2004, and before January 1, 2009.
- Was not employed by the taxpayer in the previous six months.
- His or her services in California during the taxable year are directly related to the taxpayer's manufacturing trade or business.
- He or she is employed with the taxpayer for at least 270 days. This test would be met if the termination of the employee within the first 270 days were:
    - voluntary on the part of the employee;
    - caused by the employee becoming disabled; or
    - due to certain defined employee misconduct.

In the case of a pass-through entity, the determination of whether a taxpayer qualifies for the credit would be made at the entity level. The credit would be allowed to the pass-through entity and passed through to the partners or shareholders.

All employees of businesses that are under common control or members of the same controlled group of corporations would be treated as employed by a single taxpayer. This would prevent controlled groups of taxpayers from transferring employees between members to trigger or increase the credit.

If a major portion of a business is acquired from another employer, the employment relationship between the employee and the new employer would be treated the same as the employment relationship between the employee and the prior employer. The new employer would "step into the shoes" of the old employer for purposes of qualifying for future credits.

Credit amounts in excess of tax liability could be carried forward and applied against tax liability for up to eight years. If the taxpayer is allowed more than one credit for wages paid, the taxpayer must choose which one credit to claim.

IMPLEMENTATION CONSIDERATIONS

The bill defines a qualified employee as an employee who provides services that are directly related to the conduct of the taxpayer's manufacturing trade or business. However, the bill does not define "directly related," which could lead to disputes between taxpayers and the department regarding whether an employee would qualify for the credit. It is also unclear whether this requirement is designed to prevent non-manufacturing jobs of the qualified taxpayer (i.e., administrative, accounting, legal, or secretarial) from qualifying for this credit, or whether something else is intended.

TECHNICAL CONSIDERATIONS

- The bill provides a specified credit amount, based upon the amount of pay, for each year of the employee's employment. This could be interpreted to mean that in the second year of employment the employee could qualify the taxpayer for a $2,000 ($1,000 x 2 years of employment) credit, or it could mean the credit is $1,000 each year and may be claimed each year that the taxpayer employs the employee. According to the author it should be $1,000 each year per qualified employee. Amendments 1, 2, 6, and 7 would clarify this issue.

- Amendments 3, 4, and 5 would make the Personal Income Tax credit consistent with the Corporate Tax credit. These changes were inadvertently omitted from the April 20, 2004, amendments.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

Revenue Estimate

The amendments reduced the revenue losses from $160 million to $150 million for fiscal year 2004/05. The revenue effects of this proposal over the initial three-year period are projected to be as follows:

Fiscal Year Cash Flow Impact Enactment Assumed After 6/30/04 $ Millions		
2004-5	2005-6	2006-7
- 150	- 290	- 400

This analysis does not take into account any change in employment, personal income, or gross state product that may result from this bill becoming law.

Revenue Discussion

According to the California Statistical Abstract, there were more than 1.6 million employees in manufacturing in California in 2002. Based on an analysis of corporation sample data, it is estimated that approximately 2/3 of these employees work for businesses with increasing employment levels. Thus, about 1.1 million (1.6 million x 2/3) employees work for qualified businesses. Available information indicates that 20% of all employees are new hires in any given year, it is estimated that there will be about 220,000 (1.1 million x 20%) new hires working for qualified employers each year. Assuming that 60% of these employees are qualified employees, there will be about 130,000 (220,000 x 60%) qualified employees. If the average credit per qualified employee is $1,300, the total amount of credits available will be $170 million. Assuming that employers can use only about 70% of these credits produces an estimated revenue loss of $120 million in the 2004 taxable year (70% of $170 million = $120 million). In succeeding years, taxpayers will be able to claim a similar amount of credits for:

- New hires,
- Qualified employees hired in earlier years of the program that remain with the company, and
- Carryover credits that were not used in the year generated.

The losses presented in the table above are adjusted to represent fiscal year impacts.

POLICY CONCERNS

Conflicting tax policies result when a credit is provided for an item that is already deductible as a business expense (double tax benefit). On the other hand, making an adjustment to reduce the business expense in order to eliminate the double benefit creates a difference between state and federal taxable income, which is contrary to the state's general federal conformity policy.

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO AB 2365
As Introduced/Amended

AMENDMENT 1

On page 2, line 36, after "($1,000)" insert

per taxable year

AMENDMENT 2

On page 3, line 3, after "($1,500)" insert:

per taxable year

AMENDMENT 3

On page 3, line 25, before "employee" insert:

qualified

AMENDMENT 4

On page 4, line 4, strikeout "both" and insert:

all

AMENDMENT 5

On page 4, line 33 after "succeeding" insert:

seven

AMENDMENT 6

On page 6, line 35, after "($1,000)" insert

per taxable year

AMENDMENT 7

On page 6, line 39, after "($1,500)" insert:

per taxable year